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February 17, 2005

BY E-FILE AND OVERNIGHT COURIER

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: Bay State Gas Company, D.T.E. 04-93

Dear Ms. Cottrell:

Enclosed for filing, on behalf of Bay State Gas Company ("Bay State"), please find an original and six (6) copies of the Bay State's Brief in support of its request for recovery of Lost Base Revenue as an Exogenous Cost.

Please do not hesitate to telephone me with any questions whatsoever.

Very truly yours,

Patricia M. French

cc: Jody Stiefel, Esq., Hearing Officer
Andreas Thanos, Assistant Director, Gas Division, DTE
Dr. Alexander Kofitse,, DTE
Carmen Liron-Espana, DTE
Tim Cargill, DTE
Service List

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

INITIAL BRIEF OF
BAY STATE GAS COMPANY

REQUEST FOR RECOVERY
OF EXOGENOUS COST

D.T.E. 04-93

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I. INTRODUCTION

Consistent with the approval granted by the Department of Telecommunications and Energy ("Department") in D.T.E. 03-36, Bay State Gas Company ("Bay State") seeks authority to collect exogenous costs of $2,437,286 arising from the Department's change in policy regarding recovery of Lost Base Revenues ("LBR") caused by the installation of Demand Side Management ("DSM") programs. See, Bay State Gas Co., D.T.E. 03-36 (Mar. 25, 2004) ("D.T.E. 03-36"). In early 2004, the Department found Bay State's recovery of this type of cost, calculated in the same manner as that presented in this docket, to be appropriate for exogenous cost recovery. D.T.E. 03-36 at 15. [1]

II. SUMMARY

When Bay State's current five-year rate plan was approved, the Department had allowed Bay State to collect LBR over the entire useful life of an installed DSM measure. A year following the Department's approval of the Bay State rate plan, the Department announced a new policy, called the Rolling Period Method ("RPM") recovery mechanism, that limited Bay State's recovery of LBR to no more than four years for a DSM measure. This change in regulatory policy was beyond Bay State's control and had a significant effect on Bay State's financial operations. Accordingly, Department precedent and the terms of Bay State's rate plan allowed Bay State to seek to collect the LBR attributable to such a policy change through an exogenous cost factor filing.

Because, as in D.T.E. 03-36, Bay State's filing once again meets the requirements of Department approval of exogenous cost recovery resulting from this regulatory policy change,

[1] In D.T.E. 03-36, the Department acknowledged that its precedent provided for exogenous cost recovery of LBR resulting from a change in the Department's regulatory policy. D.T.E. 03-36 at 12.

Bay State asks that the Department grant its approval and permit Bay State to recover this cost as a factor in its Local Distribution Adjustment Clause ("LDAC"). This is Bay State's last request for exogenous cost recovery for LBR related to the Department's change in policy to RPM.

III. BACKGROUND

On March 25, 2004, in D.T.E. 03-36, the Department approved Bay State's first request for exogenous cost recovery of LBR based on the requirements of G.L. c. 164, § 76, the Department's decision in NIPSCo-Bay State Acquisition, D.T.E. 98-31 (Nov. 5, 1998) ("NIPSCo-Bay State Acquisition") and the Department's approval of similar requests made by Colonial Gas Company ("Colonial"). See, D.T.E. 03-36 at 14-16. Bay State's recovery of the exogenous costs incurred from September 2001 through August 2002 associated with LBR commenced, subject to the reconciliation provisions in Bay State's Local Distribution Adjustment Clause, on November 1, 2003. Bay State's recovery of the D.T.E. 03-36-approved LBR will cease on October 31, 2004.[2]

On May 14, 2004, Bay State filed its second petition for LBR recovery under its exogenous cost factor, to commence November 1, 2004. Bay State Gas Co., D.T.E. 04-57 (*pending*). Bay State began recovering its LBR in its LDAC subject to refund pursuant to Department authorization, pending final approval of its petition.

On October 26, 2004, Bay State filed its third and last petition for LBR recovery under its exogenous cost factor, to commence January 1, 2005.[3] In the instant docket, Bay State seeks authority to collect $2,437,286 in LBR as an exogenous cost incurred for the period September

[2] In other words, the present request for recovery of LBR, if granted, will not overlap with the prior grant because the recovery under D.T.E. 03-36 was almost entirely recovered in 2004 and will end before the recovery granted in D.T.E. 04-57 would begin (November 1, 2004).

[3] If approved, Northern believes the actual start date for recovery would be May 1, 2005. RR-DTE-1-3.

2003 through August 2004. As in D.T.E. 03-36 and consistent with the amount sought for recovery in D.T.E. 04-57, the instant request represents the annual amount that Bay State would have collected if the LBR policy that was in effect when the Department approved the Bay State rate plan had not been subsequently changed.

Pursuant to notice duly issued, the Department held a public hearing on December 16, 2004 and set an intervention deadline of December 9, 2004 for the proceeding. No persons appeared to oppose Bay State's proposal and no parties sought to intervene. On February 3, 2005, the Department held an evidentiary hearing at its offices in Boston. In support of its Petition, Bay State presented the in-hearing testimony and exhibits of Joseph A. Ferro.

The evidentiary record consists of Bay State's pre-filed testimony and schedules (Exh. BSG-1), responses to information requests (Exh. DTE-1-1 through Exh. DTE-1-13), and Bay State's responses to the Department's record requests (DTE-RR-1 and DTE-RR-2).

IV. STANDARD OF REVIEW

A. Standard of Review for DSM Impact Evaluations

In its Order approving Bay State's 2003 request for exogenous cost recovery associated with the change in the Department's LBR policy, the Department articulated its standard of review for approving Bay State's savings estimates generated as LBR. D.T.E. 03-36 at 8-10. The Department stated that the impact evaluation provided by Bay State would be considered to be reliable if the energy savings estimates included in the evaluation were sufficiently unbiased and were measured to a sufficient level of precision. D.T.E. 03-36 at 11; see also, D.T.E. 02-73 at 2-3; D.P.U. 96-98. In the past, the Department noted that the application of measure-specific realization rates to gross therm savings that were used to calculate the net therm savings, and

"the weather 'normalization' of the annual therm savings for the heating measures both produced energy savings estimates of a sufficient level of precision." D.T.E. 03-36 at 11.

B. Standard of Review for Exogenous Cost Recovery

The Department next evaluated whether Bay State met the standards for recovery of LBR through an exogenous cost adjustment. The Department reiterated its standard that Bay State must show that (1) the cost change is of a type that is external to Bay State and is "beyond the company's control;" (2) the magnitude of the cost change would significantly affect Bay State's operations; and (3) Bay State's earnings, independent of recovering a proposed exogenous cost, are reasonable. D.T.E. 03-36 at 13 (citing, Colonial Gas Co., D.T.E. 00-73 at 21). [4]

In particular, any LDC seeking the recovery of exogenous costs caused by a change in LBR policy must "propose exogenous cost adjustments, with supporting documentation and rationale, to the Department for determination as to the appropriateness of recovery of the proposed exogenous costs." D.T.E. 03-36 at 11; Eastern Enterprises-Colonial Gas Co. Acquisition, D.T.E. 98-128 at 55 (July 15, 1999) ("Eastern-Colonial Acquisition") citing NIPSCo-Bay State Acquisition, at 17-18. The Department noted that it has defined exogenous costs as "positive or negative cost changes beyond a company's control that would significantly affect that company's operations." NIPSCO-Bay State Acquisition at 17. See also, Eastern-Colonial Acquisition at 54; Eastern-Essex Acquisition, D.T.E. 98-27 at 19 (Sept. 17, 1998) ("Eastern-Essex Acquisition"); Colonial Gas Co., D.T.E. 00-73 at 21 (Nov. 20, 2001) ("D.T.E.

[4] In addition to granting exogenous cost recovery to Bay State for LBR in D.T.E. 03-36, the Department has approved the recovery of exogenous costs caused by a change in its LBR policy three other times, with consistent application of its precedent. See Colonial Gas Co., D.T.E. 01-73 (Aug. 7, 2002); Colonial Gas Co., D.T.E. 00-73 (2001); cf. Berkshire Gas Company, D.T.E. 01-56 (Jan. 31, 2002) ("D.T.E. 01-56") (LBR could not be recovered as an exogenous cost under a rate plan that was approved after the change in the Department's LBR policy took effect).

00-73"). The Department's precedent implicitly recognizes that a "significant" effect may result if a company was unable to pursue rate relief as the result of a rate plan or price cap in effect.[5]

In D.T.E. 03-36, the Department acknowledged that its precedent provided for exogenous cost recovery of LBR resulting from a change in the Department's regulatory policy. D.T.E. 03-36 at 12. In addition, the Department stated that, in order for the Department to entertain a request by Bay State for exogenous cost recovery, the cost incurred must meet or exceed Bay State's monetary threshold in a particular year before Bay State can request recovery. See, D.T.E. 03-36 at 12 citing, NIPSCO-Bay State Acquisition at 18; Boston Gas Co., D.P.U. 96-50 (Phase I) at 293; Eastern-Colonial Acquisition at 55-56.

Finally, Bay State's rate plan is not a performance-based regulation ("PBR") plan: therefore, the Department stated that Bay State's earnings are also a factor in the Department's consideration of its request for recovery of exogenous costs. D.T.E. 03-36 at 13; Eastern-Essex Acquisition at 16.

V. DISCUSSION

A. Bay State's Calculation of Savings Impact is Unbiased, Reasonably Precise and Consistent with Precedent

In order for Bay State to meet the Department's requirements for cost recovery in this proceeding, it must demonstrate that its savings impact estimates are "sufficiently unbiased" and measured to an acceptable level of precision. Bay State has met this standard by presenting its calculation of its LBR attributable to installed DSM measures, and the portion of that LBR that has not been recovered under the four-year rolling period method for the period September 2003

[5] All of these cases involved some type of price cap or rate freeze arrangement in which a utility assumes the risk of changes in its cost structure (positive and negative) for some period of time, tempered by the ability to seek recovery of costs caused by certain factors beyond the utility's control.

to August 2004. In this proceeding, the exogenous cost represents the LBR that would have been allowed in the current year if the RPM had never been implemented less the amount of LBR that is recoverable using the RPM. Exh. BSG-1, Sch. BSG-1 at Attachment B. This same calculation was employed by Bay State in each of its exogenous cost calculation filings for LBR recovery, including one that has been approved by the Department in a final order. See D.T.E. 03-36 at 4-5. This method of calculation has also been used in similar proceedings. See also, D.T.E. 01-73 at 13-17 (calculation used by Colonial); D.T.E. 00-73 at 14-19 (calculation used by Colonial); D.T.E. 96-98 at 15, 22.

The LBR computation by measure and customer sector used by Bay State for many years is well-established and has been approved by the Department. Exh. BSG-1, Sch. BSG-1 at Att. D; D.T.E. 03-36 at 3-6, 10-11; Bay State Gas Co., D.P.U. 95-117 (1996). The LBR computation was described by Bay State in this proceeding, is supported thoroughly by documentation, and is consistent with the method used by Bay State and approved by the Department in D.T.E. 03-36. Exh. BSG-1 at 9-12; Exh. BSG-1 at Att. F; Exh. DTE-1-5.

The LBR calculation is performed on a monthly basis for each type of measure installed in connection with the relevant rate class. Exh. BSG-1, Sch. BSG-1 at Att. D, Att. F. The calculation begins with engineering benchmarks for therm savings of cost-effective DSM measures, in accordance with Bay State's energy efficiency program filings in D.P.U. 96-76, D.P.U. 96-98 and D.T.E. 01-27. Id.; Exh. BSG-1 at 9-12; see also, Bay State Gas Co., D.T.E. 04-39 (Sept. 13, 2004). The therm savings used in the calculation are generated by Bay State's administrative and energy auditing vendors who determine the energy savings. Id.; Exh. DTE-1-6. These vendors utilize software that has been approved by the Massachusetts Division of Energy Resources ("DOER"), or alternatively, use industry-accepted energy modeling software

and practices. Id. The annual therm savings are extracted from Bay State's DSM tracking database and aggregated by measure type, by rate class and by month of installation, and transferred into the LBR calculation model. Exh. BSG-1 at Att. D and Workpapers.

The LBR calculation model performs the following calculations for all measures by rate class:

- The annual therm savings (gross savings) are adjusted by the measure-specific realization rates to derive the net therm savings. The realization rates represent the relationship between the gross therm savings and the therm savings actually realized by the performance of a sample of the installed measures.

- Annual therm savings for heating measures are divided by annual normal effective degree days ("EDD"). The resulting per EDD unit savings are multiplied by the actual observed monthly EDDs to develop monthly actual savings. For non-heating measures, the annual savings are multiplied by approximately 1/12 to determine the monthly savings.

- These total monthly therm savings by measure are then summed to yield the total therm savings in a given month for that measure.

- The computed monthly savings for each measure are then zeroed out for any month where the installed measure's age has exceeded its expected average service life.

- The resulting normalized monthly therm savings by measure are then multiplied by the weighted average incremental net revenue rates by rate class for the given month to generate total monthly lost base revenues for the particular measure.

- All lost base revenues for each particular measure are then summed to produce the total lost base revenue for all measures for the given month.

Exh. BSG-1 at Sch. BSG-5; BSG-1 at Att. B; Exh. BSG-1 at Sch. BSG-3.

The administrative and energy auditing vendor that determines energy savings under Bay State's residential DSM program is Honeywell DMC ("Honeywell"). Exh. DTE 1-8. As described in D.T.E. 03-36 and D.T.E. 04-53, Honeywell's trained Residential Conservation Services ("RCS") certified field auditors enter the gross or expected energy savings for each program participant and each DSM measure installed based on engineering algorithms developed by Honeywell. See, id. Bay State uses prescriptive energy savings estimates determined in

support of the statewide GasNetworks® collaborative and incorporated into Bay State's approved energy efficiency program. Exh. DTE-1-6; Exh. DTE-1-16; see also, Bay State Gas Co., D.T.E. 04-39 (Sept. 13, 2004).

Bay State has received Department approval of its monitoring and evaluation studies ("M&E studies") related to the delivery of its Residential Efficiency Programs. Bay State Gas Co., D.P.U. 95-117 (1995). These M&E studies, "Process Evaluation of the Bay State Gas Company Residential DSM 'Partners in Energy' Program" and "Impact Evaluation of Residential Partners in Energy Program" were conducted by HAGLER BAILLY CONSULTING and XENERGY. The original realization rates used to represent the relationship between the *gross therm savings* and *therm savings actually realized* were developed and derived in these M&E Studies. Exh. DTE 1-8. The realization rates for residential boilers and furnaces were updated based on an engineering analysis performed by ARTHUR D. LITTLE in 1997 and subsequent studies by GDS Associates in support of the statewide GasNetworks® Programs in 2001 and 2004. Exh. DTE 1-6. The Department has found that the use of engineering benchmarks and energy audits to calculate energy savings is appropriate for the types of energy efficiency programs Bay State has in use. D.T.E. 03-36 at 10 citing D.T.E. 00-73, D.T.E. 01-73.

With regard to the small/medium Commercial & Industrial ("C&I") and multifamily program, Bay State has tapped RISE Engineering ("RISE") to determine energy savings. Exh. D.T.E. 1-8. For its large C&I energy efficiency program, Bay State currently acts as its own administrative vendor, utilizing energy savings calculated and determined by the independent engineering firms that are associated with specific projects. Id. To gain additional precision where possible, Bay State will employ energy savings calculated and determined by manufacturers of highly specialized process equipment and heat transfer applications. Id.

RISE estimates potential energy savings following an audit and interview of potential participants. All buildings served by RISE are modeled using the Market Manager Energy Analysis System. Id. All energy using equipment is modeled on an hourly basis by this software, which uses standard ASHRAE algorithms in heating and cooling load calculations based on normalized local weather conditions, creating an energy use simulation, which is compared against actual historic use and other relevant benchmarks. Id.

Bay State's M&E studies related to the delivery of its C&I/Multifamily Energy Efficiency Programs have also been approved by the Department. Bay State Gas Co., D.P.U. 96-98 (1996): see also, Exh. DTE-1-8. The Department found that Bay State's impact evaluations were "complete and clearly presented, with all data and assumptions sufficiently explained." Id.; see D.P.U. 96-98 at 3 (impact evaluation savings estimates were based on billing analyses incorporating multiple regression analysis and customer-specific engineering savings estimates). For the multifamily program, Bay State had used a matched comparison group to correct for non-program influences on energy consumption and a multiple regression analysis to correct for non-program influences on C&I energy consumption. Id. The Department found that the impact evaluations were appropriate and its realization rates were reasonable and sufficiently unbiased. See D.P.U. 96-98 at 4, 7, 8. Finally, the Department reviewed Bay State's LBR calculation and found that Bay State had calculated the LBR correctly using the results of the M&E studies and information on degree days and rates. Exh. D.T.E. 1-5.[6]

For the 12-month period ending August 31, 2004, the total net therm savings for all DSM measures by RPM was 5,928,682 therms. Exh. BSG-1 at Att. H. For residential heating DSM

[6] In D.P.U. 96-98, the Department directed Bay State to utilize the cost of capital from its most recent rate case to calculate LBR. Id. at 10. Bay State has incorporated its pre-tax cost of capital from that rate case to calculate LBR. Exh. DTE-1-1.

measures, the total net therm savings was 2,339,613 therms. Id. The total net therm savings for residential non-heating measures was 14,646 therms. Id. The equivalent net therm savings for multi-family and C&I measures were 853,546 therms and 2,720,877 therms, respectively. For the 12-month period ending August 31, 2004, the total LBR for all measures installed under DSM, based on net therm savings by RPM, was $1,258,209, including carrying costs of $145,621. Exh. BSG-1 at Att. G. For the residential heating measures, the LBR was $581,512 including carrying costs of $64,341. Id. For residential non-heating measures, the LBR was $7,182 including carrying costs of $803. Id. For the multi-family and C&I measures, the LBRs were $174,801 and $494,714, respectively, including carrying costs of $21,027 and $59,450, respectively. Id.

Beginning in 2000, Bay State no longer recovered total LBR associated with all its conservation activities because the Department's adoption of RPM restricted its recovery to those measures installed within the last four (4) years. Based on the method that was endorsed by the Department before RPM, the total net therm savings for the 12-month period ending August 31, 2004 was 18,803,251 therms. Exh. BSG-1 at Att. H. For residential DSM measures, the total net therms savings was 6,860,926 therms. Id. For residential non-heating measures, the total net therm savings was 131,226 therms. Id. The equivalent net therm savings for multi-family and C&I measures were 3,587,890 therms and 8,223,207 therms, respectively. Id. Using the old method, the total LBR for all measures installed, based on net therm savings since the inception of Bay State's DSM programs, is $3,695,495, including carrying costs of $228,676. Exh. BSG-1 at Att. G. For residential heating measures, the LBR was $1,667,785, including carrying cost of $101,095. Id. For residential non-heating measures, the LBR was $40,429 including carrying cost of $2,001. Id. For multi-family and C&I measures, the LBRs were

$575,694 and $1,411,587, respectively. Id. The carrying costs for the multi-family and C&I measures were $34,748 and $90,832, respectively. Id

The exogenous cost of $2,437,286 is calculated as the difference between the total LBR under the prior method (that is, $3,695,495) and the total LBR under the RPM (that is, $1,258,209). Exh. BSG-1 at Att. G. Similarly, Bay State calculated the associated carrying costs of $83,055 as the difference between the total carrying costs under the prior method (that is, $228,676) and the total carrying costs by RPM (or $145,621). Id.

As described above, the record in this proceeding demonstrates that the Department has previously approved Bay State's method of calculating LBR and the M&E studies used in this proceeding. D.T.E. 03-36; D.P.U. 95-117; D.P.U. 96-98. See also, Exh. BSG-1, Sch. BSG-1 at Att. 1; Exh. BSG-1 at Sch. BSG-1; Exh. DTE-1-6; Exh. DTE-1-8. The record in this proceeding also shows that Bay State's estimates of energy savings and the method for calculating exogenous cost recovery for LBR is reviewable, reliable and appropriate. Id. As such, the calculation of impact savings can be relied upon if the Company otherwise meets the tests for exogenous cost recovery.

B. Bay State Should be Permitted to Recover its LBR as an Exogenous Cost

As in D.T.E. 03-36 and D.T.E. 04-93, Bay State requests to recover as an exogenous cost LBR that would have been collected but for the change in the Department's LBR policy. Bay State's request meets all of the elements required of an exogenous cost filing. The costs at issue were caused by a change in regulatory policy uniquely affecting the local gas distribution industry that was external to Bay State and beyond its control, and which would have a substantial effect on Bay State's operations. Bay State's earnings, independent of recovering a proposed exogenous cost, (as well as including recovering the proposed exogenous cost of

$2,437,286) are below its allowed rate of return. See Schedule BSG-1, Attachment A, page 1 of 2; Exh. DTE-1-1; Exh. DTE-1-2 (Supplemental). As such, Bay State's request should be approved.

1. The LBR Exogenous Costs are the Result of the Regulatory Change Previously Determined to be Beyond Bay State's Control

As the Department found in D.T.E. 03-36, under the Department policy in effect when Bay State filed and the Department approved Bay State's merger case, Bay State would have been allowed to recover LBR over the full useful life of installed DSM measures. See, e.g., Bay State Gas Co., D.P.U. 96-98 (Aug. 6, 1997) ("D.P.U. 96-98"). Over a year after approving Bay State's merger and rate plan, the Department changed the method by which LDCs may calculate recoverable LBR. See Colonial Gas Co., D.T.E. 97-112 at 32 (Nov. 17, 1999) (the Department adopted the "rolling period method" ("RPM"), under which LBR could be recovered for a period of time only equal to the average length of time between the last four (4) base rate cases). Therefore, as the Department found in D.T.E. 03-36, the first element of the standard for Bay State's exogenous cost recovery is met – the costs sought for recovery were caused by a regulatory change made by the Department that uniquely affected the local gas distribution industry, in this case, the change in the Department's LBR policy. The change was external to Bay State and beyond Bay State's control.

2. The Cost Resulting From the Change in Regulation Has a Significant Effect Exceeding the Exogenous Cost Threshold Determined by the Department

As part of Bay State's approved rate plan, the Department established a monetary threshold for exogenous cost recovery of $500,000. NIPSCO-Bay State Acquisition, at 18. The cost impact of the change in Department regulatory policy of $2,437,286 for which Bay State

seeks an exogenous cost adjustment clearly exceeds the Department-established threshold by more than four times. Exh. DTE-1-13. The threshold acts as a proxy for a showing that the costs involved are sufficient to have a substantial effect on a company's operations; Bay State is not required, for example, to let its operations actually deteriorate before being able to recover exogenous costs. See, e.g., D.T.E. 00-73 at 21. The record clearly establishes that a revenue shortfall as large as the $2,437,286 sought in this case would have a significant impact on Bay State's operations. The second part of the standard is met.

3. Bay State's Earnings, Independent of the Proposed Exogenous Cost Recovery, are Reasonable and Therefore Support the Requested Recovery

With respect to the third element of the standard, the Department stated that during the duration of a rate plan, a company's earnings would be a factor when considering the appropriateness of recovery of an exogenous cost. D.T.E. 03-36 at 13-14. In D.T.E. 03-36 involving Bay State and in past exogenous cost recovery cases involving Colonial, the Department reviewed the most recent calendar year return on common equity ("ROE"), and compared that ROE to the ROE allowed by the Department for an LDC in the most recently litigated base rate case in determining whether the third part of the standard had been met. See D.T.E. 03-36 at 13-14; see also D.T.E. 01-73 at 17-18; D.T.E. 00-73 at 23.

The record shows that Bay State's 2004 weather-normalized ROE was 9.3 percent when the proposed exogenous cost recovery of $2,437,286 is included. Exh. BSG-1 at 8-9; Exh. DTE-1-2 (Supplemental); RR-DTE-1-2.[7] The Department has extensive precedent demonstrating that it conducts earnings analyses based on a jurisdictional company's weather normalized earnings, precisely because the impact of weather is beyond an LDC's control. With or without the

[7] Bay State's 2003 weather-normalized ROE, including the requested LBR as an exogenous cost, is 10.19%. Exh. DTE-1-3; Exh. DTE-1-3 (Supplemental); RR-DTE-1-2.

proposed recovery, this ROE is below the ROEs granted in the most recently litigated base rate case for a gas distribution company in Massachusetts, and below the ROE granted in Bay State's last base rate proceeding.[8] Exh. BSG-1 at 8-9 (Bay State approved ROE is 11.40%); D.T.E. 03-40 (2004) (Boston Gas granted ROE of 10.5%); D.T.E. 01-56 (2002) (Berkshire Gas granted ROE of 10.5%); D.T.E. 02-24/25 (2002)(FG&E granted lower ROE of 10%, with circumstances cited).

In order to make the demonstration required by the Department, Bay State presented its ROE calculation for the 12-months ending December 2004. In this calculation the Company included the earnings impact of the entire annualized proposed exogenous cost recovery of LBR revenues of $2,437,286, and eliminated the impact of the LBR preliminarily booked for recovery pursuant to the Department's tentative LDAC authorization and under D.T.E. 04-53. Exh. DTE-1-2 (Supplemental). The weather-normalized ROE for 2004 was still below Bay State's allowed ROE and the ROE granted by the Department in its most recently litigated base rate case.

The Department's inquiry in assessing earnings for the purposes of exogenous cost recovery is focused on the reasonableness of Bay State's most recent weather-normalized annual earnings. Since Bay State's 2004 earnings, calculated by various methods, do not exceed the most recently granted ROE by the Department to Boston Gas of 10.5%, Bay State's earnings must be considered reasonable and consistent with the Department's appropriate grant of exogenous cost recovery.

Accordingly, the level of Bay State's earnings supports its petition for an exogenous cost adjustment for LBR recovery.

[8] Bay State's currently approved ROE is 11.4 percent. Exh. BSG-1 at 8.

VI. CONCLUSION

Bay State's request for recovery of LBR in the amount of $2,437,286 meets the Department standard for exogenous cost recovery in accordance with the Department's final orders in D.T.E. 03-36, Bay State's merger and rate plan, its tariff, and long-held Department precedent. As in D.T.E. 04-57 and in D.T.E. 03-36, the costs Bay State seeks to recover were caused by a regulatory change that was beyond Bay State's control and of a magnitude to have a significant effect on Bay State's operations. Bay State's earnings, independent of recovering the proposed exogenous cost, are reasonable. The Department reviewed and approved Bay State's 2003 request to recover LBR as an exogenous cost, has pending but permits Bay State to recover a second request subject to its final order (D.T.E. 03-57), and has approved five (5) such filings by Colonial Gas Company, each of which presented identical issues. Accordingly, for the reasons contained herein, Bay State respectfully requests that the Department grant Bay State's request for recovery of LBR as an exogenous cost adjustment in the amount of $2,437, 286 for the period September 1, 2003 through August 31, 2004.

Respectfully submitted,

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By its attorney,

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Dated: February 17, 2005